

# PUNITIVE DAMAGES FOR BREACH OF CONTRACT

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The common law rule, adhered to in the great majority of states, is that punitive damages may not be assessed in an action for breach of contract, no matter what the circumstances of malice, abuse, wantonness or oppression that attend the breach.<sup>1</sup> Basically the reason is an unwillingness to extend the doctrine of punitive damages to the commercial field thus introducing uncertainty and confusion into business transactions, and also the feeling that substituted performance in terms of compensatory damages is an adequate remedy for the aggrieved party to a contract. To turn a jury loose with power to give to the plaintiff, not only the sum in dollars equal to the value to the plaintiff of defendant's promised performance, but in addition thereto an amount twenty or fifty times that sum as punitive damages, seems to most courts an unequal weighting of the scales between the contending parties not justified by any factor of punishment or deterrent.

In a small but growing minority of states, punitive damages are allowed in breach of contract cases where the breach is accompanied by a fraudulent act or some other intentional wrong, insult, abuse or gross negligence amounting to an independent tort, aggravated by malice, wantonness, or oppression. The minority rule had its beginning in an early South Carolina case decided in 1904.<sup>2</sup> There defendant had loaned money and taken as security a deed absolute intended as a mortgage, giving his promise in writing to reconvey the land to plaintiff upon payment of the loan. In breach of this contract, defendant conveyed the land to a third party bona fide purchaser before the loan was due. Plaintiff sued for breach claiming \$2,000 damages, presumably \$215 actual damages and \$1,785 punitive damages. The demurrer to the complaint was overruled and the supreme court affirmed, stating the rule in South Carolina which has ever since obtained, that "when breach of a contract is accompanied by a fraudulent act . . . the defendant may be made to respond in punitive as well as compensatory damages."<sup>3</sup> The court reasoned that the fraudulent act of conveying away plaintiff's land amounted to an independent tort for which defendant could be held for exemplary damages in a tort action because of the malicious and fraudulent nature of the act, and to deny the same recovery merely because the suit was in contract would be to give undue effect to the common law forms of action abolished by the South Carolina code of 1870.

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<sup>1</sup> See cases collected in Annot., 84 A.L.R. 1345 (1933).

<sup>2</sup> Welborn v. Dixon, 70 S.C. 108, 49 S.E. 232 (1904).

<sup>3</sup> *Id.* at 115.

On the authority of the *Welborn case*, the rule in South Carolina came to be firmly established in a long line of decisions beginning in 1931.<sup>4</sup> A large number of the cases were contract actions against insurance companies, with both compensatory and punitive damages allowed where the breach was accompanied by a fraudulent act.<sup>5</sup>

It is not necessary for recovery of punitive damages that the fraudulent act occur in connection with and at the time of the breach of contract. It may occur prior to formation of the contract and as an inducement thereto. For example, misrepresentation by the insurer's agent as to the content of the policy to be issued was held to justify a judgment for \$100 actual damages and \$400 punitive damages in an action on the policy,<sup>6</sup> and misrepresentation by a broker as to the actual sale price of land is such an independent tort as will justify a verdict of \$1,000 punitive damages against the broker in addition to the \$300 overpayment for which restitution was sought and recovered.<sup>7</sup>

Secondly, the fraudulent act may occur during the performance of the contract and before breach. In a recent New Mexico case,<sup>8</sup> by the contract of sale, buyer was to harvest and weigh the crop sold and pay the agreed price in accordance with the results of the weighing. On his nonpayment, the seller sued for breach of contract, alleging, in addition to the nonpayment, fraud on the buyer's part in falsifying the weights in order to cheat the seller. The supreme court upheld the verdict for punitive damages, saying: "In this state we have recognized the right to an award of punitive damages in an action for breach of contract, if the breach is accompanied by a fraudulent act, wanton in character and maliciously intentional."

Thirdly, the fraudulent act or other independent tort may occur at the time of and in connection with the breach. Wrongful discharge of an employee in a contract for a stated term of employment when accompanied by gratuitous and unjustified charges that the employee is a liar, made before others, justifies the employee in an action for breach of contract to a verdict for \$500 exemplary damages in addition to her actual damages.<sup>9</sup> The manner in which the contract is breached may amount to an independent tort for which punitive damages may be

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<sup>4</sup> *Bradley v. Metropolitan Ins. Co.*, 162 S.C. 303, 160 S.E. 721 (1931). In this case the company agent by fraudulent representations obtained possession of plaintiff's policy; and the company, denying liability and retaining possession, repudiated the contract. In the suit for breach of contract, plaintiff got a verdict for \$186 actual and \$2,000 punitive damages, which was affirmed.

<sup>5</sup> For citations and analysis of the cases see Howser, *The Awarding of Punitive Damages for Breach of Insurance Contracts in South Carolina*, 1 S.C.L.Q. 150 (1948), and a very complete note, *Punitive Damages for Breach of Contract*, 10 S.C.L.Q. 444 (1958).

<sup>6</sup> *Thomas v. American Workmen*, 197 S.C. 178, 14 S.E.2d 886 (1941).

<sup>7</sup> *Briggs v. Rodriguez*, 236 S.W.2d 510 (Tex. Civ. App. 1951).

<sup>8</sup> *Whitehead v. Allen*, 63 N.M. 460, 313 P.2d 335 (1957).

<sup>9</sup> *Scheps v. Giles*, 222 S.W. 348 (Tex. Civ. App. 1920).

assessed if aggravated by malice or willful disregard of the injured party's rights. A lessor who wrongfully evicts a tenant, and by force appropriates the tenant's improvements to his own use, may be held in punitive damages in a contract action for breach of the lease.<sup>10</sup> Where a hotel manager in connection with the wrongful discharge of a clerk physically seized her and shoved her into a public room, the independent tort at the time of the breach entitled the clerk to punitive damages.<sup>11</sup> Breach may occur in the exercise of a right by the defendant, and the independent tort may be in the grossly negligent manner in which the right is exercised. So a lumber company with timber rights on a tract bordering plaintiff's pasture, bound to maintain plaintiff's fence, which fells its trees in such a negligent manner as to break down the fence, may be held in punitive damages where the destruction of the fence is extensive and so persistently continued after protest as to evidence a willful disregard of the rights of the plaintiff.<sup>12</sup> A lessor who in making improvements to the leased property carries the improvements to the extent of destroying the lessee's restaurant business, may be held in punitive damages in a contract action.<sup>13</sup>

Finally, where the fraudulent act or other independent tort occurs after the breach, punitive damages may never be recovered in an action on the contract. Though the breach may occur in such manner as to constitute a tort, tortious conduct committed after the breach, no matter how malicious or inexcusable, will not justify an allowance of punitive damages in the contract action,<sup>14</sup> nor may a tort committed after the breach be shown for the purpose of showing malicious intention at the time of the discharge. The motives of the party to a contract who repudiates it are legally irrelevant where there is no fraudulent act or other independent tort committed in connection with the breach. Where the only wrong is the breach, in no state can more than compensatory damages be recovered. A discharged employee cannot point to the withholding of the money he would have earned had he not been discharged as the "fraudulent act" or tortious conduct necessary to justify an allowance of punitive damages.<sup>15</sup> The short answer here is that such money withheld is not plaintiff's money. A debtor who withholds payment of his debt cannot be said to be thereby misappropriating or converting the money of the creditor. The money he withholds is his own money.

The statement has often been made in the past, and is frequently reiterated, that South Carolina is the only state in which punitive damages

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<sup>10</sup> *Franklin Plant Farm v. Nash*, 118 Va. 98, 86 S.E. 836 (1915).

<sup>11</sup> *Dallas Hotel Co. v. McCue*, 25 S.W.2d 902 (Tex. Civ. App. 1930).

<sup>12</sup> *Fair Lumber Co. v. Weems*, 196 Miss. 201, 16 So.2d 770 (1944).

<sup>13</sup> *Anchor Co. v. Adams*, 139 Va. 388, 124 S.E. 438 (1924).

<sup>14</sup> *Oklahoma Fire Ins. Co. v. Ross*, 170 S.W. 1062 (Tex. Civ. App. 1914).

<sup>15</sup> *Holland v. Spartanburg Herald-Journal Co.*, 166 S.C. 454, 165 S.E. 203 (1932).

may be recovered in an action for breach of contract.<sup>16</sup> In fact, however, a number of other American jurisdictions must be listed as having the minority rule permitting punitive damages in a proper case. In a long line of cases in Texas beginning in 1890, punitive damages have been allowed in contract actions where the breach is accompanied by an independent tort aggravated by malice or wanton disregard of the plaintiff's rights.<sup>17</sup> In Mississippi, judgments including punitive damages have been upheld in contract actions where the breach was accompanied by an intentional wrong or gross negligence amounting to an independent tort.<sup>18</sup> The same is true in Virginia<sup>19</sup> and Nevada.<sup>20</sup>

Since 1952, an increasing number of cases have been decided approving assessment of exemplary damages in contract actions within the requirements above described, so that to the list of states applying the minority rule may be added New Mexico<sup>21</sup> and Iowa.<sup>22</sup> In three other states, Kansas,<sup>23</sup> Missouri,<sup>24</sup> and Florida,<sup>25</sup> the supreme courts have indicated by dicta in recent decisions that punitive damages will be allowed in breach of contract cases where the breach is accompanied by an independent tort actuated by malice, willful wrong, or gross negligence.

#### CONCLUSION

The states following the minority rule permitting punitive damages in contract cases seem to fall into two categories, which for the purpose of brevity we may call the South Carolina rule (breach accompanied by a fraudulent act), and the Texas rule (breach accompanied by any independent tort). At first glance, availability of punitive damages to the plaintiff seems broader under the Texas rule, since the accompanying tort is not limited to fraud. But probably the contrary is true. Under

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<sup>16</sup> See Howser, *supra* note 5; Mooney, *Punitive Damages for Breach of Insurance Contracts in South Carolina*, 1955 INS. L.J. 20.

<sup>17</sup> Carter Lumber Co. v. Saide, 140 Tex. 523, 168 S.W.2d 629 (1943); Hooks v. Fitzenrieter, 76 Tex. 277, 13 S.W. 230 (1890); Briggs v. Rodriguez, *supra* note 7; National Finance Co. v. Fregia, 78 S.W.2d 1081 (Tex. Civ. App. 1935); National Finance Co. v. Abernathy, 66 S.W.2d 358 (Tex. Civ. App. 1934); Dallas Hotel Co. v. McCue, *supra* note 11; Morgan v. Steinberg, 23 S.W.2d 527 (Tex. Civ. App. 1929); Scheps v. Giles, *supra* note 9; Littlefield v. Clayton Bros., 194 S.W. 194 (Tex. Civ. App. 1917); Westfall v. Perry, 23 S.W. 740 (Tex. Civ. App. 1893).

<sup>18</sup> American Ry. Express v. Bailey, 142 Miss. 622, 107 So. 761 (1926); Fair Lumber Co. v. Weems, *supra* note 12.

<sup>19</sup> Anchor Co. v. Adams, *supra* note 13; Franklin Plant Farm v. Nash, *supra* note 10.

<sup>20</sup> Burrus v. Nevada-C.-O. Ry., 38 Nev. 156, 145 Pac. 926 (1915).

<sup>21</sup> Whitehead v. Allen, *supra* note 8.

<sup>22</sup> Kuiken v. Garrett, 243 Iowa 785, 51 N.W.2d 149 (1952).

<sup>23</sup> Mabery v. Western Cas. & Sur. Co., 173 Kan. 586, 250 P.2d 824 (1952); Moffett v. Kansas City Ins. Co., 173 Kan. 52, 244 P.2d 228 (1952).

<sup>24</sup> Williams v. Pub. Ser. Co., 294 S.W.2d 36 (Mo. 1956).

<sup>25</sup> Griffith v. Shamrock Village, 94 So. 2d 854 (Fla. 1957).

the Texas rule, before the plaintiff can recover punitive damages the facts must be such that he actually has two causes of action, one in tort and one in contract. Under the South Carolina rule, the action for breach of contract may be the only action open to the plaintiff, as where the accompanying fraudulent act is a mere omission for which no tort action in deceit would lie.<sup>26</sup>

Where the plaintiff has a choice between two causes of action, in contract or tort, and punitive damages are available if he pursues the latter remedy because of the aggravated nature of the tort, there seems little to criticize in a rule which permits punitive damages in an action for breach of the contract. Allowing such damages where they also could have been allowed had plaintiff sued in tort adds no advantage to the injured party nor puts the wrongdoer in any worse position. Moreover, under modern procedure the plaintiff pleads facts, not a form of action, and where the facts justify the assessment of punitive damages they should be so assessed whether plaintiff's theory of action be labeled contract or tort.

The rule in South Carolina, however, does not restrict punitive damages in contract to the case where an independent tort action would lie. Therefore its justification must be found in a judicial policy for the suppression of fraud by means of punishment and example. One cannot read the insurance cases without a feeling that the moderate punitive damages assessed and approved must have had a salutary effect in inducing more careful control by the companies over the fraudulent tactics of their agents, a control particularly necessary considering the ignorance and trusting character of the segment of the public with whom they primarily deal. The rule makes possible the punishment of a fraud committed by omission, a wrong for which in the majority jurisdictions the law has failed to provide an adequate remedy.

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<sup>26</sup> An example is the failure of an insurance agent to collect premiums against established custom, with intent to cause the policy to lapse because of increase in risk. *Hutcherson v. Pilgrim Ins. Co.* 227 S.C. 239, 87 S.E.2d 685 (1955); *Bradley v. Washington Ins. Co.*, 170 S.C. 509, 171 S.E. 243 (1933) (verdict \$48 actual and \$1,475 punitive damages affirmed).